

ALTERNATIVE FORECASTS

Global Insight has assigned a 60% probability of occurrence to its September 2004 baseline forecast of the U.S. economy. The major features of this forecast include:

- Real GDP increases 4.3% in 2004, 3.3% in 2005, 2.9% in 2006, and 3.2% in 2007;
- U.S. nonfarm employment grows 1.0% in 2004, 1.7% in 2005, 1.1% in 2006, and 0.9% in 2007;
- the U.S. civilian unemployment rate hovers near 5.5%;
- consumer inflation is 2.6% in 2004, 1.9% in 2005, 1.5% in 2006, and 1.79% in 2007; and
- the federal unified budget deficit peaks at \$432 billion in 2004 then gradually declines to \$284 billion in 2007.

In the baseline forecast the expansion is self-sustaining. It is possible, however, growth is on the verge of faltering. High energy prices, rising food prices, heavy debt burdens, and rising interest rates may be eroding consumers' ability to spend. A return to weak employment growth, unexpectedly high inflation, and no gains in real income could force the Federal Reserve to choose between fighting inflation and encouraging growth. The pessimistic alternative assumes the fed battles inflation. The optimistic scenario resembles the late 1990s. This scenario recognizes the power of momentum. As the decade-long expansion of the 1990s showed, once an economy gets up a head of steam, it is difficult to slow it down.

OPTIMISTIC SCENARIO

The *Optimistic Scenario* has been assigned a 20% probability of occurrence. A few key assumptions distinguish the *Optimistic Scenario* from the baseline. In this *Scenario*, total factor productivity is higher than in the baseline. This helps the economy expand faster without rekindling inflation. Job growth is also stronger, while budget deficits are much smaller. This *Scenario* assumes stronger foreign growth boosts exports despite a stronger dollar. In addition to these key assumptions, oil prices are lower and construction is stronger.

These assumptions produce a rosier outlook than in the baseline. Although economic growth and job gains are stronger, inflation is actually lower than in the baseline thanks to the strong dollar and higher productivity gains. The lower inflation rate allows the Federal Reserve to be more accommodating than in the baseline. Real GDP rises 4.3% in 2004, 3.9% in 2005, 3.8% in 2006, and 3.6% in 2007. In the baseline, real GDP grows 4.3% in 2004, 3.3% in 2005, 2.9% in 2006, and 3.2% in 2007. In the *Optimistic Scenario*, nonfarm employment advances 1.0% this year, 1.8% next year, 1.6% in 2006, and 1.2% in 2007. The labor market's strength is also evident in the civilian unemployment rate, which declines from 5.5% to 5.1% over the forecast horizon. In contrast, the unemployment rate remains near 5.5% during the forecast period in the baseline case. Nonfarm employment grows 1.0% in 2004, 1.7% in 2005, 1.1% in 2006, and 0.9% in 2007.

The higher U.S. productivity presents a mixed outlook for Idaho. It is a slight plus for Gem State employment. Specifically, nonfarm employment advances a healthy 2.3% this year, 1.7% next year, 1.9% in 2006, and 1.8% in 2007. As a result, Idaho nonfarm employment is about 200 higher than in the *Baseline Forecast*. But looking at total employment does not give the complete picture, because individual sectors perform differently. As the table shows, the goods-producing sector's employment prospers in this *Scenario*, and is nearly 2,300 higher than the baseline in 2007. In contrast, the nongoods-producing sector's employment is actually lower than in the baseline in 2007. Interestingly, the higher

IDAHO ECONOMIC FORECAST
BASELINE AND ALTERNATIVE FORECASTS
OCTOBER 2004

	BASELINE				OPTIMISTIC				PESSIMISTIC			
	2004	2005	2006	2007	2004	2005	2006	2007	2004	2005	2006	2007
GDP (BILLIONS)												
Current \$	11,713	12,341	12,917	13,579	11,717	12,384	13,036	13,717	11,701	12,248	12,828	13,541
% Ch	6.4%	5.4%	4.7%	5.1%	6.5%	5.7%	5.3%	5.2%	6.3%	4.7%	4.7%	5.6%
2000 Chain-Weighted	10,825	11,184	11,509	11,874	10,828	11,245	11,677	12,094	10,815	11,101	11,364	11,689
% Ch	4.3%	3.3%	2.9%	3.2%	4.3%	3.9%	3.8%	3.6%	4.2%	2.6%	2.4%	2.9%
PERSONAL INCOME - CURR \$												
Idaho (Millions)	37,518	39,361	41,494	43,761	37,504	39,155	40,886	42,669	37,475	39,367	41,894	44,885
% Ch	6.0%	4.9%	5.4%	5.5%	6.0%	4.4%	4.4%	4.4%	5.9%	5.0%	6.4%	7.1%
U.S. (Billions)	9,647	10,115	10,635	11,211	9,648	10,130	10,684	11,261	9,637	10,066	10,610	11,274
% Ch	5.3%	4.8%	5.1%	5.4%	5.3%	5.0%	5.5%	5.4%	5.2%	4.4%	5.4%	6.3%
PERSONAL INCOME - 2000 \$												
Idaho (Millions)	34,787	35,848	37,153	38,421	34,779	35,784	36,888	37,863	34,742	35,664	37,058	38,649
% Ch	3.7%	3.0%	3.6%	3.4%	3.7%	2.9%	3.1%	2.6%	3.6%	2.7%	3.9%	4.3%
U.S. (Billions)	8,945	9,212	9,522	9,843	8,947	9,258	9,639	9,993	8,934	9,119	9,385	9,708
% Ch	3.0%	3.0%	3.4%	3.4%	3.0%	3.5%	4.1%	3.7%	2.9%	2.1%	2.9%	3.4%
TOTAL NONFARM EMPLOYMENT												
Idaho	585,972	595,856	606,734	618,202	585,950	596,067	607,533	618,394	585,699	594,348	603,987	616,321
% Ch	2.4%	1.7%	1.8%	1.9%	2.3%	1.7%	1.9%	1.8%	2.3%	1.5%	1.6%	2.0%
U.S. (Thousands)	131,242	133,416	134,856	136,097	131,249	133,652	135,755	137,412	131,039	132,450	133,030	133,971
% Ch	1.0%	1.7%	1.1%	0.9%	1.0%	1.8%	1.6%	1.2%	0.8%	1.1%	0.4%	0.7%
GOODS-PRODUCING SECTOR												
Idaho	104,414	103,818	102,734	101,893	104,425	104,310	104,533	104,170	104,340	103,276	101,172	100,070
% Ch	2.0%	-0.6%	-1.0%	-0.8%	2.0%	-0.1%	0.2%	-0.3%	1.9%	-1.0%	-2.0%	-1.1%
U.S. (Thousands)	21,898	22,270	22,371	22,349	21,898	22,362	22,739	22,806	21,860	22,098	21,953	21,759
% Ch	0.4%	1.7%	0.5%	-0.1%	0.4%	2.1%	1.7%	0.3%	0.2%	1.1%	-0.7%	-0.9%
NONGOODS-PRODUCING SECTOR												
Idaho	481,558	492,038	504,000	516,308	481,524	491,757	503,000	514,224	481,360	491,071	502,816	516,251
% Ch	2.4%	2.2%	2.4%	2.4%	2.4%	2.1%	2.3%	2.2%	2.4%	2.0%	2.4%	2.7%
U.S. (Thousands)	109,345	111,147	112,486	113,748	109,350	111,290	113,016	114,606	109,179	110,352	111,077	112,211
% Ch	1.1%	1.6%	1.2%	1.1%	1.1%	1.8%	1.6%	1.4%	1.0%	1.1%	0.7%	1.0%
SELECTED INTEREST RATES												
Federal Funds	1.3%	2.8%	3.5%	3.5%	1.3%	2.7%	3.0%	3.0%	1.3%	3.7%	5.9%	6.8%
Bank Prime	4.3%	5.8%	6.5%	6.5%	4.3%	5.7%	6.0%	6.0%	4.3%	6.7%	8.9%	9.8%
Existing Home Mortgage	5.7%	6.5%	6.7%	6.8%	5.7%	6.4%	6.1%	6.1%	5.7%	6.7%	8.0%	8.7%
INFLATION												
GDP Price Deflator	2.1%	1.9%	1.7%	1.9%	2.1%	1.7%	1.4%	1.6%	2.1%	1.9%	2.3%	2.6%
Personal Cons Deflator	2.2%	1.8%	1.7%	2.0%	2.1%	1.7%	1.4%	1.6%	2.2%	2.3%	2.4%	2.7%
Consumer Price Index	2.6%	1.9%	1.5%	1.7%	2.6%	1.5%	1.0%	1.4%	2.6%	2.4%	2.3%	2.6%

Forecast Begins the SECOND Quarter of 2004

productivity dampens unit labor cost, which lowers Idaho wage growth. The lower wage growth has a cascading effect on several components of Idaho personal income. As a result, Idaho nominal personal income is lower than its baseline counterpart. Interestingly, even after adjusting for inflation, Idaho personal income is still lower in this *Scenario* than in the *Baseline Scenario*.

PESSIMISTIC SCENARIO

The *Pessimistic Scenario* has been assigned 20% probability of occurrence. A significant feature of the *Pessimistic Scenario* is the re-emergence of inflation. The pickup of inflation reflects higher oil prices, a weaker dollar, and two-and-one half years of accommodative monetary policy, and loose fiscal policy. In addition, higher prices are fueled by the ability of businesses to pass more of their costs to their customers. Two other factors cause prices to rise faster than in the baseline. There may actually be less spare manufacturing capacity than is currently believed. This is because rapid technological advances may have rendered obsolete much of the idle capacity the Federal Reserve has been including in its estimates of capacity. Global growth is hampered by the anti-growth regulatory and social policies in Europe.

The economy does not sink into a recession in this scenario, but merely fails to come as close to its potential. Real GDP is one-half percentage point lower in 2005 and 2006 than its baseline counterparts. As mentioned, inflation is higher, despite the weaker aggregate economy. Nonfarm employment grows slower than in the baseline. The combination of sluggish growth and high inflation raises fears of stagflation. The Federal Reserve attacks inflation with earnest, causing its federal funds rate to climb quickly to 6.75%. After 2006, the economy starts to catch up, but the composition is different from the baseline. Production shifts from satisfying domestic demand to serving foreign demand.

In this *Scenario*, the outlook for Idaho employment is weaker than in the *Baseline Scenario*, but the personal income forecast is stronger. Specifically, Idaho nonfarm employment advances 2.3% in 2004, 1.5% in 2005, 1.6% in 2006, and 2.0% in 2007. In this *Scenario*, Idaho goods-producing employment shrinks annually after 2004. This being the case, the nongoods-producing sector is the engine for job growth. Both Idaho nominal and real personal income increase faster than their baseline counterparts after this year. Nominal income increases by 5.0% in 2005, 6.4% in 2006, and 7.1% in 2007. In the *Baseline Scenario*, Idaho nominal income never grows faster than 6.0%. As a result, Idaho nominal personal income is over \$1 billion higher in 2007 in the *Pessimistic Scenario*. Adjusting for inflation narrows the growth gap between pessimistic and baseline Idaho personal income, but does not erase it.